

## APPENDIX C

### **STATEMENT OF THE JOINT OVERSIGHT TEAM FOR THE SBC COMMUNICATIONS INC. SECTION 272 BIENNIAL AUDIT**

Section 272(d) of the Communications Act of 1934 ("the Act"), as amended, requires a Bell operating company ("BOC") operating a Section 272 separate affiliate to obtain a biennial audit to determine whether it has complied with the various requirements of Section 272. These agreed-upon procedures ("AUP") audit engagements are overseen by a Joint Federal/State Oversight Team that is comprised of representatives from the affected states and the Federal Communications Commission. The Joint Federal/State Oversight Team ("JOT") tasked with overseeing the engagement looking into SBC's Section 272 compliance has formulated the engagement procedures to be performed in this audit, discussed the procedures with SBC, and reviewed the independent auditor's report and supporting workpapers. The JOT offers the following statement concerning the procedures of this audit engagement.

On May 19, 2003, the JOT released the procedures to be performed by the independent external auditor Ernst & Young ("E&Y") in the engagement covering the period July 2001 through July 2003. When it released the procedures, the JOT labeled specific procedures as "open" pending further study and discussion with SBC. In particular, the JOT left open Objective VIII, Procedure 4 ("Procedure VIII-4"), which sought performance data to determine whether SBC had fulfilled its nondiscrimination requirements. The JOT had revised this procedure for the second SBC audit to include the submission and analysis of performance data for resold intraLATA toll service, exchange access services provided on a retail basis to large customers, and the provision of unbundled network elements based on the experience of the FCC and the states with prior Section 272 audits

At that same time, E&Y proceeded to perform the audit field work, including the revised Procedure VIII-4. However, because Procedure VIII-4 was still open, SBC did not provide all of the data specified in the revised procedure to E&Y. Instead, SBC and the JOT agreed that SBC would provide the same data that was used in the first Section 272 audit pending closure of the procedure and specification of final requirements. E&Y notified the JOT and SBC that work on this procedure would progress but would be incomplete pending closure of the procedure and receipt of all requested data from SBC.

In late July, the JOT contacted SBC to attempt to close Procedure VIII-4, but the JOT and SBC were unable to agree to the JOT's revised Procedure VIII-4 as the final, closed procedure. It appeared to the JOT that, due to time constraints, SBC would not be able to produce all the data necessary to perform the desired Procedure VIII-4 completely in the current SBC audit period. The JOT therefore closed Procedure VIII-4 on November 26, 2003, to reflect SBC's and the JOT's most recent agreements as to Procedure VIII-4. The current closed Procedure VIII-4, shown in Appendix B, and completed by E&Y, differs slightly from the revised procedure first proposed by the JOT, as well as from the procedure performed in the first SBC audit. In the future, the JOT will continue to work with SBC, and all other BOCs subject to the Section 272 audits, to refine the data gathering requirements, including further revisions of Procedure VIII-4.



December 15, 2003

Mr. Hugh Boyle  
Federal Communications Commission  
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Mr. Brian Horst  
Ernst & Young LLP  
Frost Bank Towers, Suite 1900  
100 West Houston Street  
San Antonio, Texas 78209-2938

**Re: Section 272 Biennial Audit of SBC Communications Inc.**

Dear Messers Boyle and Horst

SBC Communications Inc. ("SBC") submits these comments to Ernst & Young's audit report pursuant to Section 272(d) of the Communications Act of 1934, as amended ("the Act") and Section 53.209 of the Commission's rules. These comments are being submitted to the Joint Federal/State Oversight Team ("JOT") and to Ernst & Young ("E&Y") in accordance with Section 53.213(b) of the Commission's rules and will become part of the final audit report.

The results of the Agreed-Upon Procedures, as reflected in the Final Audit Report, reveals that SBC has effectively implemented internal policies, procedures and practices to comply with the Section 272 requirements of the Act. Due to the nature of an agreed-upon procedures engagement, the practitioner has performed the procedures as agreed to by the users and has reported all results, regardless of materiality. Accordingly, the audit report includes minor exceptions.

SBC provides these comments to address certain procedures or results noted in the practitioner's audit report that may require additional information or clarification.

Sincerely,

A handwritten signature in dark ink, appearing to read "Michelle Thomas", with a long, sweeping horizontal line extending to the right.

Attachment

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### Objective V/VI, Procedure 5

Using the sample of 80 agreements selected in Procedure 4 above, documented in the working papers the dates when the agreements were signed and/or when the services were first rendered (whichever took place first) and the dates of posting on the Internet. Noted that ten (12.5%) of the 80 agreements tested were posted to the SBC Internet site more than ten days after their effective date. Since this 12.5% error rate exceeded the expected error rate of 1% used to determine the sample size, consulted with the Joint Oversight Team and determined to expand testing to cover the entire population of 183 agreements posted to the Internet during the Audit Test Period. From the additional testing noted 3 additional late postings. Attachment A-2 lists the 13 affiliate agreements that were posted to the Internet more than ten days after their effective date.

For the affiliate agreement, "IP/PI Master License & Sharing Agreement" between Wisconsin Bell and SBCS, effective November 3, 2000, noted that this agreement was re-posted to the SBC Internet site on November 16, 2001. SBC represented that during a review of agreements posted to the SBC Internet site they determined that the link to this agreement was not functional, however the summary of the agreement and the pricing methodology were still listed on the Internet. The agreement was re-posted on November 16, 2001 to correct this problem. This agreement was reviewed in conjunction with Ernst & Young's prior report for the period July 10, 2000 to July 9, 2001 dated December 17, 2001 and was determined to be available on the SBC Internet site as of March 29, 2001.

*The purpose of this procedure is to determine whether unaffiliated carriers are adequately notified of all transactions between the BOC and its section 272 affiliate so they can request the same services at the same prices and on the same terms and conditions*

Of the thirteen agreements, seven related to joint marketing services which, under section 272(g) of the Act, the BOCs are *not required* to make available to unaffiliated carriers. Moreover, six of these seven agreements were merely addenda to existing agreements that were already posted to the Internet, therefore, most of the information on the pricing, terms and conditions of the agreement was available to outside parties. Finally, only two of these seven agreements were posted more than two weeks late; the other five were posted within two days. Thus, the harm to competitors is negligible because not only are joint marketing agreements specifically exempt from the nondiscrimination requirements of section 272(g), but most of the agreements were already posted on the Internet and did not change materially.

Of the remaining six agreements that were not related to joint marketing services, all but one were posted within two and a half weeks. Furthermore, two of the six agreements were also simply pricing addenda - the main agreements were already available on the Internet.

These late postings were due to inadvertent errors and SBC has made remedial changes to ensure that agreements are posted to the Internet in a timely manner. For example, in addition to the primary employees responsible for ensuring timely postings, a manager in the Regulatory department of SBCS will be conducting a weekly check to ensure that the agreements have been posted on time.

It should be noted that no unaffiliated third party entity has requested service provided from the SBC BOCs to the 272 affiliates for the non-tariffed agreements posted on the Internet web site.

[See also Section b. of the "Follow-up Procedures on the Prior Engagement"]

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	section of the report]
<p><b><u>Objective VII, Procedure 1</u></b></p> <p>This Management Response addresses the scope of this procedure in the General Standard Procedures rather than the results in the report</p>	<p><i>The purpose of this procedure is to determine whether SBC had engaged in discriminatory procurement practices in awarding contracts to its 272 affiliates over third parties</i></p> <p>Although SBC <i>does not disagree</i> with the way this procedure was performed in the current audit, SBC believes that this procedure should be performed in a manner more consistent with its plain reading and intent in future biennial audits. This procedure involves three steps. First, it requires the auditors to review all bids submitted by the section 272 affiliate and third parties for the BOC procurement awards to each section 272 affiliate and to review SBC records and interview its relevant personnel to determine how the selection was made. Second, it requires the auditors to disclose only those BOC procurement awards to the section 272 affiliates where the terms of the bids submitted by third parties are <i>more favorable</i> than those submitted by the section 272 affiliates. And finally, for those awards to the section 272 affiliates where the terms of the bids submitted by third parties are more favorable, the auditor is to disclose the differences between the terms submitted by the section 272 affiliates and third parties.</p> <p>During the audit, even though there were <i>no instances</i> where the terms of the bids submitted by third parties were more favorable than those submitted by the section 272 affiliates, the report disclosed an award to the section 272 affiliate and noted the differences between the terms submitted by the section 272 affiliate and third parties. This disclosure was based on a reading of the third step of the procedure, with the concurrence of the FCC staff and JOT, which required the disclosure of all bids where there are differences between the terms submitted by third parties and the section 272 affiliates regardless of which party received the procurement award.</p> <p>SBC believes this is not the best reading of the procedure. To read the third step broadly to include disclosure of <i>all</i> bids by the section 272 affiliate would render the second step redundant. That is, there would be no need for a procedure requiring the auditors to disclose bids where the terms submitted by</p>

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	<p>third parties are more favorable than those submitted by the section 272 affiliates, if the later procedure required the auditors to disclose <i>all</i> bids and <i>all</i> differences in the terms. This reading is also inconsistent with the objective of the procedure, which is to test SBC's compliance with section 272(c) nondiscriminatory procurement requirements and to note differences <i>only</i> for awards to the section 272 affiliates where the terms of the bids from third parties are more favorable than those of the section 272 affiliates.</p> <p>Because SBC brought this issue to the attention of the Commission and the JOT very late in the audit process, it is not disputing the procedure as performed for this year. However, SBC would like to revisit this issue with the Commission and the JOT for the next audit.</p>
<p><b><u>Objective VIII, Procedure 5</u></b></p> <p>For the selected months, applied the business rules to the underlying raw data and compared the results to those tracked and maintained by the SBC BOC for that performance metric. Application of the business rules considered the definitions, exclusions, calculations and reporting structure included in the business rules. All differences noted for PMs 1, 2, 4, 5, 6 and 7 are included in the workpapers. Differences greater than 1% and all differences in the day, six-hour or one-hour increment that 95% was achieved are listed in Attachment A-9. No differences were noted for PM 3.</p>	<p><i>The purpose of this procedure is to recalculate the SBC 272(e)(1) performance results and compare to the reported results and note any differences.</i></p> <p>SBC tracks and maintains 272(e)(1) performance results on a monthly basis. The auditors recalculated, for a sample of months during the engagement period, SBC's performance results covering all states in which SBC had received section 271 approval. The auditors performed the recalculations between June and August of 2003, in some cases almost two years after the original performance results were calculated and reported by SBC. The differences between the performance results calculated by SBC and those calculated by the auditors are primarily because of the time lag between the two calculations. This time lag can skew the results for the following reasons:</p> <ul style="list-style-type: none"><li>○ Performance results are based on a snapshot in time such that calculations of the same performance results, performed at different periods, may not be based on identical raw data. Thus, for example, the raw data used by the auditors in July 2003 to recalculate the July 2001 performance results for Texas may have included either more or less orders than the raw data originally used by SBC in July 2001. This necessarily results in minor differences.</li></ul>

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- Some of the data obtained by the auditors to recalculate performance results for Service Categories 1, 2, 5 and 7 was originally obtained by SBC from different systems. The standard system used today – and that was used by the auditors to obtain the data for the recalculations – is called ASKME (Acquisition of Statistical Knowledge Made Easy). This is now SBC's central data storage system that houses all the "source" data from the various systems that generate the raw data. However, SBC started using this system only in 2003, thus, the raw data used by SBC to calculate the performance results in previous years was obtained directly from the various "source" systems rather than ASKME. Because some of the raw data changed when it was transferred from the "source" systems to the central data storage system in 2003, this could have caused differences in the recalculated performance results.
- The classification of entities into reporting categories (Section 272 Affiliates, BOC and Other Affiliates, and Non-Affiliates) is based on the ACNA (Access Customer Name Abbreviation) codes assigned to each customer of access services. Once a quarter, SBC obtains the ACNA list from an official industry organization website. Because the ACNA list obtained from the website is often inaccurate, SBC must manually review, and frequently update and revise, the list. For example, an ACNA may incorrectly reflect a wholesale carrier customer as a retail end-user customer and vice versa. Depending on when the errors in the ACNA list were discovered and corrected, the ACNAs used by SBC when the performance results were originally calculated and when the auditors performed the recalculations may have been different. This results in differences in the recalculations. SBC is in the process of developing a mechanized process to automatically update the ACNA list rather than relying on a manual process to review and update the list each quarter. This will ensure that ACNAs are not mistakenly left off the list or put in the wrong category thereby minimizing differences going forward.

The differences between the auditor recalculations and the SBC reported performance results for Service Category 4 were due to a difference in the methodology used to define the intervals. SBC calculates the 6-hour interval

up to and including the 6<sup>th</sup> hour (0-6, 7-12, etc.) However, the auditors calculated the 6-hour interval up to, but excluding the 6<sup>th</sup> hour (0-5 99, 6-11 99, etc.) Thus, whenever the desired percentage occurred on the 6<sup>th</sup> hour of the interval (6, 12, etc.), the auditor results were pushed into the next 6-hour grouping, while SBC's results were not, resulting in a difference of (1) interval